Nos. 20799, 20800, 20801

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MIRRO-DYNAMICS CORPORATION,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal From the Judgment of the United States District Court for the Southern District of California.

APPELLANT'S REPLY BRIEF.

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The Government, without conceding the insufficiency of Asst. U. S. Attorney Greenwald's affidavit, takes the position (Govt. Br. 15) in a footnote that the affidavit is merely surplusage, as the material there set forth is found in the pleadings, admissions, depositions, and answers to interrogatories. Appellant's brief (p. 33) shows the deletions in the so-called "undisputed facts" set forth in the lower court's Decision and what would remain if the source and support thereof were limited to the pleadings, admissions, and answers to interrogatories.

Based on the immaterial residuum, there is no doubt that there are triable issues of fact and summary judgment was improvidently granted. In fact the bulk of the facts comprising the Government's Statement of Facts (p. 2) are culled from the claims for refund appended to the complaints as Exhibit A, although the Government in its Answers "denies all allegations of fact and conclusions of law contained in Ex. A not otherwise expressly admitted." [R. 114, 330, 361]. Other than jurisdictional allegations, very little was expressly admitted in these Answers. As a result the claims for refund [R. 5] do not support the facts in the Government's Statement. In addition the references to the admissions [R. 71-72] do not support the facts there set forth.

The lower court did NOT have before it

(1) the corporate purposes in the Articles of Incorporation; or

(2) any corporate minutes; or

(3) any evidence of intent on the part of plaintiff in the everyday operation of its business; or

(4) the scope and ambit of plaintiff's activities, except for the facts which the Government requested the plaintiff to admit concerning its brokerage accounts and whether it belonged to various organizations; or

(5) the information necessary to determine the correct amount of income and deductions from which the correct tax could be computed.

The Government Has Not Rebutted the Foregoing.

Apparently the gist of the Government's argument (pp. 14-15) is that plaintiff could prevail only if it had customers and that since it was not a member of any stock exchange or registered with the SEC as a broker-dealer or licensed to sell securities in California, it must have had no customers as a matter of fact. Without conceding the validity of this premise, Appellant cannot believe that the Government is now urging that tax consequences turn on what a taxpayer can legally do rather than on what a taxpayer intended to do and actually did do. There was nothing before the lower court as to the taxpayer's intent in this connection. In response to Government requests for admissions, plaintiff did admit that it "did not acquire orders or funds from private investors" for securities and that it "did not sell or authorize the sale" of securities for private investors [R. 129]. This merely means that it did not conduct a brokerage business. There has never been any contention that plaintiff was a broker.

The lower court apparently found [R. 282] that the stock transactions were solely for plaintiff's account, which is correct since the plaintiff was not, and did not purport to be, a broker acting as an agent rather than a principal. Whether a taxpayer buys or sells a security as a principal, for his own account, is totally irrelevant and immaterial to the determination of whether capital gain or ordinary income results. A taxpayer who is allowed to inventory securities as a dealer as defined in U.S. Treas. Reg. §1.471-5 purchases securities for his own account to be held in inventory. When he sells securities from his inventory, he is then selling as a principal for his own account. The

SEC definition of dealer (Appt. Br. 38) so provides. Ethically he is required to sell such a security at a net price without any commission, since he is acting as a principal and not as a broker who would charge a commission for acting as an agent. A broker ordinarily derives his income from commissions generated by his activities as an agent, resulting in ordinary income.

A §471-5 dealer's activities also yield ordinary income with respect to his inventory of securities, as they are excluded from capital assets because they are stock in trade. It is not, as the Government urges (p. 12-3), because it is in return for services which he performs in keeping a supply of securities on hand and permitting another principal or broker access to that supply.

There is no doubt that the Government is confusing brokers with dealers. To the extent that stocks rise in price during the time that they are owned by the §471-5 dealer, his profit contains an element of gain other than remuneration for his labors in carrying on his brokerage activities, and his losses reflect the risk of loss which he bore in exactly the same manner as the taxpayer in this case. Without doubt, one of the economic functions of an owner of assets is to bear the depreciation or benefit from the appreciation of those assets. This function cannot be separated from the ownership of such assets.

If a §471-5 dealer had the misfortune to spend the whole year buying high and selling low as did this taxpayer, would the Government contend that because the loss resulted from a decline in the value of the securities the dealer bought and sold day by day, it was not an operating loss?

When a corporation chooses to engage in the business of buying and selling assets, it is putting its capital at the risk of the market in the assets. If the price rises, the corporation is rewarded for taking that risk by its profit on those assets, and this income which it generates from its day to day operations in buying and selling those assets is ordinary income, whether the assets consist of guns, butter, diamonds or securities. Similarly if the price falls, the corporation incurs a loss which no one will deny is an ordinary loss in the case of a corporation which buys and sells guns, butter or diamonds—and it follows that if a corporation generates ordinary loss from its daily activities in buying and selling guns, butter or diamonds, it would have ordinary loss from its daily activities in buying and selling stocks.

This is the rule of *United States v. Chinook Inv. Co.,* 136 F. 2d 984 (9th Cir. 1943), which this Court has never overruled. In addition, this opinion squarely rejects the Government's contention that only a §471 dealer's activities generate ordinary income and loss. In that case this Court specifically rejected the Government's contention here (p. 9) that "courts have *consistently* taken the position that the standard under §1221(1) and §471 is the same." (Ital. added). In fact, the only appellate opinion cited for this contention, *Com'r v. Burnett,* 118 F. 2d 661 (5th Cir. 1941) (erroneously cited as Burnet, 10th Cir. at Govt. Br. 9), this Court refused to follow in *Chinook Inv. Co., supra* at 985.

Thus, this Court considers immaterial and irrelevant the criterion adopted by the Regulations as to whether

a taxpayer is a merchant of securities in determining whether there is a trade or business with sales to customers. It is submitted that the language cited from *G. R. Kemon,* 16 T. C. 1026 (Govt. Br. 12), which the Government characterizes as a "standard explanation" is not a correct one, except insofar as it paraphrases the Regulation's definition of dealer, which by its terms is limited to inventory determinations. The only statutory definition of dealer is contained in the Securities Exchange Act of 1934, 15 U.S.C.A. §78c-(a)(5) and provides that a dealer "means a person engaged in the business of buying and selling securities *for his own account*, through a broker or otherwise. . . ." (Ital. added). Under this definition if the taxpayer were afforded its day in court, it may be able to prove that it was a dealer. **However, the pertinent provisions of the Internal Revenue Code do not turn on whether the taxpayer is a dealer.** The determination of whether plaintiff is entitled to carry back its operating losses turns on whether ordinary losses were generated from its business of buying and selling securities.

Although Appellant set forth the legislative history behind §1221(1) in a spirit of providing the Court with all points and authorities, it is submitted that it is irrelevant and immaterial.

> "Recourse may be had to legislative history of an act of Congress only where the words are ambiguous or would bring about an end completely at variance with the purpose of the statute if literally construed." *Gilbert v. Com'r,* 241 F. 2d 491, 494 (9th Cir. 1957).

The Supreme Court in *Malat v. Riddell,* 383 U.S. 569 (1966) felt that resort to the legislative history of §1221(1) was not necessary as revenue acts "should be interpreted where possible in their ordinary everyday senses." In *Helvering v. City Bank Farmers Trust Co.,* 296 U.S. 85, 89 (1935), the Court held that it was "not at liberty to construe language so plain as to need no construction, or to refer to committee reports where there can be no doubt of the meaning of the words used." Where a statute is unambiguous, a court should not "utilize legislative history to create an ambiguity." *Flex-O-Glass, Inc. v. United States,* 3 A.F.T.R. 2d 1034, 1037 (N.D. Ill. 1959).

> "It is elementary in the law of statutory construction that, absent ambiguity or an absurd or unreasonable result, the literal language of a statute controls and resort to legislative history is not only unnecessary but improper." *Elm City Broadcasting Corp. v. United States,* 235 F. 2d 811, 816 (D.C. Cir. 1956).

References to Congressional records or statements of legislators "may never be used to create doubt." *Un. Elec. Coal Cos. v. Rice,* 80 F. 2d 1, 8 (7th Cir. 1935), cert. denied 297 U.S. 714.

Accordingly, the decisions of this Court compel the conclusion that §1221(1) does not allow for differences in interpretation as to the business or assets involved, whether real property or securities, and that if a taxpayer is in a trade or business and the only manner in which benefit is to be realized from the property is ultimate sale at a profit, then the acquisition and holding must be considered for sale to customers in the ordinary course of business. (*Chinook Inv. Co.,* 136 F. 2d

984; *Ehrman,* 120 F. 2d 482, 485, cert. denied 314 U.S. 668; *Margolis,* 337 F. 2d 1001, 1004, reh. 339 F. 2d 357.)

In light of the decisions of this Circuit and the recent Supreme Court decisions (App't Br. 17), upon which the Government does not comment, there is no doubt that the authorities on which the Government relies do not withstand scrutiny and are no longer vital, as §1221(1) is in no sense of the word ambiguous and the legislative history cannot be used to tailor the statute to the facts of this case by interpreting it in different ways for real property as distinguished from securities, where the statute *is* general in its applicability.

Respectfully submitted,

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Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those Rules.

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